

§ 1.1502-27 Consolidated section 247 deduction.

(a) *Amount of deduction.* The consolidated section 247 deduction for the taxable year shall be an amount computed as follows:

(1) First, determine the amount which is the lesser of:

(i) The aggregate of the dividends paid (within the meaning of section 247(a)) during such year by members of the group which are public utilities (within the meaning of section 247(b)(1)) on preferred stock (within the meaning of section 247(b)(2)), other than dividends paid to other members of the group, or

(ii) The aggregate of the taxable income (or loss) (as determined under paragraph (b) of this section) of each such member which is a public utility.

(2) Then, multiply the amount determined under subparagraph (1) of this paragraph by the fraction specified in section 247(a)(2).

(b) *Computation of taxable income.* For purposes of paragraph (a)(1)(ii) of this section, the taxable income (or loss) of a member of the group described in paragraph (a)(1)(i) shall be determined under § 1.1502-12, adjusted for the following items taken into account in the computation of consolidated taxable income:

(1) The portion of the consolidated net operating loss deduction, the consolidated charitable contributions deduction, and the consolidated dividends received deduction, attributable to such member;

(2) Such member's capital gain net income (net capital gain for taxable years beginning before January 1, 1977) (determined without regard to any net capital loss carryover or carryback attributable to such member);

(3) Such member's net capital loss and section 1231 net loss, reduced by the portion of the consolidated net capital loss attributable to such member; and

(4) The portion of any consolidated net capital loss carryover or carryback attributable to such member which is absorbed in the taxable year.

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§ 1.1502-28 Consolidated section 108.

(a) *In general.* This section sets forth rules for the application of section 108(a) and the reduction of tax attributes pursuant to section 108(b) when a member of the group realizes discharge of indebtedness income that is excluded from gross income under section 108(a) (excluded COD income).

(1) *Application of section 108(a).* Section 108(a)(1)(A) and (B) is applied separately to each member that realizes excluded COD income. Therefore, the limitation of section 108(a)(3) on the amount of discharge of indebtedness income that is treated as excluded COD income is determined based on the assets (including stock and securities of other members) and liabilities (including liabilities to other members) of only the member that realizes excluded COD income.

(2) *Reduction of tax attributes attributable to the debtor*—(i) *In general.* With respect to a member that realizes excluded COD income in a taxable year, the tax attributes attributable to that member (and its direct and indirect subsidiaries to the extent required by section 1017(b)(3)(D) and paragraph (a)(3) of this section), including basis of assets and losses and credits arising in separate return limitation years, shall be reduced as provided in sections 108 and 1017 and this section. Basis of subsidiary stock, however, shall not be reduced below zero pursuant to paragraph (a)(2) of this section (including when subsidiary stock is treated as depreciable property under section 1017(b)(3)(D) when there is an election under section 108(b)(5)).

(ii) *Consolidated tax attributes attributable to a member.* For purposes of this section, the amount of a consolidated tax attribute (e.g., a consolidated net operating loss) that is attributable to a member shall be determined pursuant to the principles of § 1.1502-21(b)(2)(iv). In addition, if the member is a member of a separate return limitation year subgroup, the amount of a tax attribute that arose in a separate return limitation year that is attributable to that member shall also be determined pursuant to the principles of § 1.1502-21(b)(2)(iv).

(3) *Look-through rules*—(i) *Priority of section 1017(b)(3)(D).* If a member treats

stock of a subsidiary as depreciable property pursuant to section 1017(b)(3)(D), the basis of the depreciable property of such subsidiary shall be reduced pursuant to section 1017(b)(3)(D) prior to the application of paragraph (a)(3)(ii) of this section.

(ii) *Application of additional look-through rule.* If the basis of stock of a corporation (the lower-tier member) that is owned by another corporation (the higher-tier member) is reduced pursuant to sections 108 and 1017 and paragraph (a)(2) of this section (but not as a result of treating subsidiary stock as depreciable property pursuant to section 1017(b)(3)(D)), and both of such corporations are members of the same consolidated group on the last day of the higher-tier member's taxable year that includes the date on which the excluded COD income is realized or the first day of the higher-tier member's taxable year that follows the taxable year that includes the date on which the excluded COD income is realized, solely for purposes of sections 108 and 1017 and this section other than paragraphs (a)(4) and (b)(1) of this section, the lower-tier member shall be treated as realizing excluded COD income on the last day of the taxable year of the higher-tier member that includes the date on which the higher-tier member realized the excluded COD income. The amount of such excluded COD income shall be the amount of such basis reduction. Accordingly, the tax attributes attributable to such lower-tier member shall be reduced as provided in sections 108 and 1017 and this section. To the extent that the excluded COD income realized by the lower-tier member pursuant to this paragraph (a)(3) does not reduce a tax attribute attributable to the lower-tier member, such excluded COD income shall not be applied to reduce tax attributes attributable to any member under paragraph (a)(4) of this section and shall not cause an excess loss account to be taken into account under § 1.1502-19(b)(1) and (c)(1)(iii)(B).

(4) *Reduction of certain tax attributes attributable to other members.* To the extent that, pursuant to paragraph (a)(2) of this section, the excluded COD income is not applied to reduce the tax attributes attributable to the member

that realizes the excluded COD income, after the application of paragraph (a)(3) of this section, such amount shall be applied to reduce the remaining consolidated tax attributes of the group, other than consolidated tax attributes to which a SRLY limitation applies, as provided in section 108 and this section. Such amount also shall be applied to reduce the tax attributes attributable to members that arose (or are treated as arising) in a separate return limitation year to the extent that the member that realizes excluded COD income is a member of the separate return limitation year subgroup with respect to such attribute if a SRLY limitation applies to the use of such attribute. In addition, such amount shall be applied to reduce the tax attributes attributable to members that arose in a separate return year or that arose (or are treated as arising) in a separate return limitation year if no SRLY limitation applies to the use of such attribute. The reduction of each tax attribute pursuant to the three preceding sentences shall be made in the order prescribed in section 108(b)(2) and pursuant to the principles of § 1.1502-21(b)(1). Except as otherwise provided in this paragraph (a)(4), a tax attribute that arose in a separate return year or that arose (or is treated as arising) in a separate return limitation year is not subject to reduction pursuant to this paragraph (a)(4). Basis in assets is not subject to reduction pursuant to this paragraph (a)(4). Finally, to the extent that the realization of excluded COD income by a member pursuant to paragraph (a)(3) does not reduce a tax attribute attributable to such lower-tier member, such excess shall not be applied to reduce tax attributes attributable to any member pursuant to this paragraph (a)(4).

(b) *Special rules—(1) Multiple debtor members—(i) Reduction of tax attributes attributable to debtor members prior to reduction of consolidated tax attributes.* If in a single taxable year multiple members realize excluded COD income, paragraphs (a)(2) and (3) of this section shall apply with respect to the excluded COD income of each such member before the application of paragraph (a)(4) of this section.

(ii) *Reduction of higher-tier debtor's tax attributes.* If in a single taxable year multiple members realize excluded COD income and one such member is a higher-tier member of another such member, paragraphs (a)(2) and (3) of this section shall be applied with respect to the excluded COD income of the higher-tier member before such paragraphs are applied to the excluded COD income of the other such member. In applying the rules of paragraph (a)(2) and (3) of this section with respect to the excluded COD income of the higher-tier member, the liabilities that give rise to the excluded COD income of the other such member shall not be treated as discharged for purposes of computing the limitation on basis reduction under section 1017(b)(2). A member (the first member) is a higher-tier member of another member (the second member) if the first member is the common parent or investment adjustments under § 1.1502-32 with respect to the stock of the second member would affect investment adjustments with respect to the stock of the first member.

(iii) *Reduction of additional tax attributes.* If more than one member realizes excluded COD income that has not been applied to reduce a tax attribute attributable to such member (the remaining COD amount) and the remaining tax attributes available for reduction under paragraph (a)(4) of this section are less than the aggregate of the remaining COD amounts, after the application of paragraph (a)(2) of this section, each such member's remaining COD amount shall be applied on a pro rata basis (based on the relative remaining COD amounts), pursuant to paragraph (a)(4) of this section, to reduce such remaining available tax attributes.

(iv) *Ownership of lower-tier member by multiple higher-tier members.* If stock of a corporation is held by more than one higher-tier member of the group and more than one such higher-tier member reduces its basis in such stock, then under paragraph (a)(3) of this section the excluded COD income resulting from the stock basis reductions shall be applied on a pro rata basis (based on the amount of excluded COD income caused by each basis reduction)

to reduce the attributes of the corporation.

(v) *Ownership of lower-tier member by multiple higher-tier members in multiple groups.* If a corporation is a member of one group (the first group) on the last day of the first group's higher-tier member's taxable year that includes the date on which that higher-tier member realizes excluded COD income and is a member of another group (the second group) on the following day and the first group's higher-tier member and the second group's higher-tier member both reduce their basis in the stock of such corporation pursuant to sections 108 and 1017 and this section, paragraph (a)(3) of this section shall first be applied in respect of the excluded COD income that results from the reduction of the basis of the corporation's stock owned by the first group's higher-tier member and then shall be applied in respect of the excluded COD income that results from the reduction of the basis of the corporation's stock owned by the second group's higher-tier member.

(2) *Election under section 108(b)(5)—(i) Availability of election.* The group may make the election described in section 108(b)(5) for any member that realizes excluded COD income. The election is made separately for each member. Therefore, an election may be made for one member that realizes excluded COD income (either actually or pursuant to paragraph (a)(3) of this section) while another election, or no election, may be made for another member that realizes excluded COD income (either actually or pursuant to paragraph (a)(3) of this section). See § 1.108-4 for rules relating to the procedure for making an election under section 108(b)(5).

(ii) *Treatment of shares with an excess loss account.* For purposes of applying section 108(b)(5)(B), the basis of stock of a subsidiary that has an excess loss account shall be treated as zero.

(3) *Application of section 1017—(i) Timing of basis reduction.* Basis of property shall be subject to reduction pursuant to the rules of sections 108 and 1017 and this section after the determination of the tax imposed by chapter 1 of the Internal Revenue Code for the taxable year during which the member realizes

excluded COD income and any prior years and coincident with the reduction of other attributes pursuant to section 108 and this section. However, only the basis of property held as of the beginning of the taxable year following the taxable year during which the excluded COD income is realized is subject to reduction pursuant to sections 108 and 1017 and this section.

(ii) *Limitation of section 1017(b)(2)*. The limitation of section 1017(b)(2) on the reduction in basis of property shall be applied by reference to the aggregate of the basis of the property held by the member that realizes excluded COD income, not the aggregate of the basis of the property held by all of the members of the group, and the liabilities of such member, not the aggregate liabilities of all of the members of the group.

(iii) *Treatment of shares with an excess loss account*. For purposes of applying section 1017(b)(2) and § 1.1017-1, the basis of stock of a subsidiary that has an excess loss account shall be treated as zero.

(4) *Application of section 1245*. Notwithstanding section 1017(d)(1)(B), a reduction of the basis of subsidiary stock is treated as a deduction allowed for depreciation only to the extent that the amount by which the basis of the subsidiary stock is reduced exceeds the total amount of the attributes attributable to such subsidiary that are reduced pursuant to the subsidiary's consent under section 1017(b)(3)(D) or as a result of the application of paragraph (a)(3)(ii) of this section.

(5) *Reduction of basis of intercompany obligations and former intercompany obligations*—(i) *Intercompany obligations that cease to be intercompany obligations*. If excluded COD income is realized in a consolidated return year in which an intercompany obligation becomes an obligation that is not an intercompany obligation because the debtor or creditor becomes a nonmember, or because the assets of the debtor or the creditor are acquired by a nonmember in a transaction to which section 381 applies, then the basis of such intercompany obligation (or new obligation if the intercompany obligation is deemed reissued under § 1.1502-13(g)(3)) is available for reduction in respect of such ex-

cluded COD income pursuant to sections 108 and 1017 and this section.

(ii) *Intercompany obligations*. The reduction of the basis of an intercompany obligation pursuant to sections 108 and 1017 and this section shall not result in the satisfaction and reissuance of the obligation under § 1.1502-13(g). Therefore, any income or gain (or reduction of loss or deduction) attributable to a reduction of the basis of an intercompany obligation will be taken into account when § 1.1502-13(g)(3) applies to such obligation. Furthermore, § 1.1502-13(c)(6)(i) (regarding the treatment of intercompany items if corresponding items are excluded or nondeductible) will not apply to exclude any amount of income or gain attributable to a reduction of the basis of an intercompany obligation pursuant to sections 108 and 1017 and this section. See § 1.1502-13(g)(3)(i)(A)(I) and (g)(4)(i)(A).

(6) *Taking into account excess loss account*—(i) *Determination of inclusion*. The determination of whether any portion of an excess loss account in a share of stock of a subsidiary that realizes excluded COD income is required to be taken into account as a result of the application of § 1.1502-19(c)(1)(iii)(B) is made after the determination of the tax imposed by chapter 1 of the Internal Revenue Code for the year during which the member realizes excluded COD income (without regard to whether any portion of an excess loss account in a share of stock of the subsidiary is required to be taken into account) and any prior years, after the reduction of tax attributes pursuant to sections 108 and 1017 and this section, and after the adjustment of the basis of the share of stock of the subsidiary pursuant to § 1.1502-32 to reflect the amount of the subsidiary's deductions and losses that are absorbed in the computation of taxable income (or loss) for the year of the disposition and any prior years, and the excluded COD income applied to reduce attributes and the attributes reduced in respect thereof. See § 1.1502-11(c) for special rules related to the computation of tax that apply when an excess loss account is required to be taken into account.

(ii) *Timing of inclusion*. To the extent an excess loss account in a share of

stock of a subsidiary that realizes excluded COD income is required to be taken into account as a result of the application of § 1.1502-19(c)(1)(iii)(B), such amount shall be included on the group's tax return for the taxable year that includes the date on which the subsidiary realizes such excluded COD income.

(7) *Dispositions of stock.* See § 1.1502-11(c) for limitations on the reduction of tax attributes when a member disposes of stock of another member (including dispositions that result from the application of § 1.1502-19(c)(1)(iii)(B)) during a taxable year in which any member realizes excluded COD income.

(8) *Departure of member.* If the taxable year of a member (the departing member) during which such member realizes excluded COD income ends on or prior to the last day of the consolidated return year and, on the first day of the taxable year of such member that follows the taxable year during which such member realizes excluded COD income, such member is not a member of the group and does not have a successor member (within the meaning of paragraph (b)(10) of this section), all tax attributes listed in section 108(b)(2) that remain after the determination of the tax imposed that belong to members of the group (including the departing member and subsidiaries of the departing member) shall be subject to reduction as provided in section 108 and the regulations promulgated thereunder (including § 1.108-7(c), if applicable) and this section.

(9) *Intragroup reorganization—(i) In general.* If the taxable year of a member during which such member realizes excluded COD income ends prior to the last day of the consolidated return year and, on the first day that follows the taxable year of such member during which such member realizes excluded COD income, such member has a successor member, for purposes of applying the rules of sections 108 and 1017 and this section, notwithstanding § 1.108-7, the successor member shall be treated as the member that realized the excluded COD income. Thus, all attributes attributable to the successor member listed in section 108(b)(2) (including attributes that were attributable to the successor member prior

to the date such member became a successor member) are available for reduction under paragraph (a)(2) of this section.

(ii) *Group structure change.* If a member that realizes excluded COD income acquires the assets of the common parent of the consolidated group in a transaction to which section 381(a) applies and succeeds such common parent under the principles of § 1.1502-75(d)(2) as the common parent of the consolidated group, the member's attributes that remain after the determination of tax for the group for the consolidated return year during which the excluded COD income is realized (and any prior years) (including attributes that were attributable to the former common parent prior to the date of the transaction to which section 381(a) applies) shall be available for reduction under paragraph (a)(2) of this section.

(10) *Definition of successor member.* A successor member means a person to which the member that realizes excluded COD income (or a successor member) transfers its assets in a transaction to which section 381(a) applies if such transferee is a member of the group immediately after the transaction.

(11) *Non-application of next day rule.* For purposes of applying the rules of sections 108 and 1017 and this section, the next day rule of § 1.1502-76(b)(1)(ii)(B) shall not apply to treat a member's excluded COD income as realized at the beginning of the day following the day on which such member's status as a member changes.

(c) *Examples.* The principles of paragraphs (a) and (b) of this section are illustrated by the following examples. Unless otherwise indicated, no election under section 108(b)(5) has been made and the taxable year of all consolidated groups is the calendar year. The examples are as follows:

Example 1. (i) *Facts.* P is the common parent of a consolidated group that includes subsidiary S1. P owns 80 percent of the stock of S1. In Year 1, the P group sustained a \$250 consolidated net operating loss. Under the principles of § 1.1502-21(b)(2)(iv), of that amount, \$125 was attributable to P and \$125 was attributable to S1. On Day 1 of Year 2, P acquired 100 percent of the stock of S2, and S2 joined the P group. As of the beginning of

Year 2, S2 had a \$50 net operating loss carryover from Year 1, a separate return limitation year. In Year 2, the P group sustained a \$200 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, \$90 was attributable to P, \$70 was attributable to S1, and \$40 was attributable to S2. In Year 3, S2 realized \$200 of excluded COD income from the discharge of non-intercompany indebtedness. In that same year, the P group sustained a \$50 consolidated net operating loss, of which \$40 was attributable to S1 and \$10 was attributable to S2 under the principles of §1.1502-21(b)(2)(iv). As of the beginning of Year 4, S2 had Asset A with a fair market value of \$10. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and this section, Asset A had a basis of \$40 and S2 had no liabilities.

(ii) *Analysis—(A) Reduction of tax attributes attributable to debtor.* Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S2 must first be reduced to take into account its excluded COD income in the amount of \$200.

(1) *Reduction of net operating losses.* Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S2 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is reduced by \$10, the portion of the consolidated net operating loss attributable to S2, to \$40. Then, again pursuant to section 108(b)(4)(B), S2's net operating loss carryover of \$50 from its separate return limitation year is reduced to \$0. Finally, the consolidated net operating loss carryover from Year 2 is reduced by \$40, the portion of that consolidated net operating loss carryover attributable to S2, to \$160.

(2) *Reduction of basis.* Following the reduction of the net operating loss and the net operating loss carryovers attributable to S2, S2 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S2 reduces its basis in Asset A by \$40, from \$40 to \$0.

(B) *Reduction of remaining consolidated tax attributes.* The remaining \$60 of excluded COD income then reduces consolidated tax attributes pursuant to paragraph (a)(4) of this section. In particular, the remaining \$40 consolidated net operating loss for Year 3 is reduced to \$0. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$20 from \$250 to \$230. Pursuant to paragraph (a)(4) of this section, a pro rata amount of the consolidated net operating loss carryover from Year 1 that is attributable to each of P and S1 is treated as reduced. Therefore, \$10 of the consolidated net operating loss carryover from Year 1 that is

attributable to each of P and S1 is treated as reduced.

Example 2. (i) *Facts.* P is the common parent of a consolidated group that includes subsidiaries S1 and S2. P owns 100 percent of the stock of S1 and S1 owns 100 percent of the stock of S2. None of P, S1, or S2 has a separate return limitation year. In Year 1, the P group sustained a \$50 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, \$10 was attributable to P, \$20 was attributable to S1, and \$20 was attributable to S2. In Year 2, the P group sustained a \$70 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, \$30 was attributable to P, \$30 was attributable to S1, and \$10 was attributable to S2. In Year 3, S1 realized \$170 of excluded COD income from the discharge of non-intercompany indebtedness. In that same year, the P group sustained a \$50 consolidated net operating loss, of which \$10 was attributable to S1 and \$40 was attributable to S2 under the principles of §1.1502-21(b)(2)(iv). As of the beginning of Year 4, S1's sole asset was the stock of S2, and S2 had Asset A with a \$10 value. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and this section, S1 had an \$80 basis in the S2 stock, Asset A had a basis of \$0, and neither S1 nor S2 had any liabilities.

(ii) *Analysis—(A) Reduction of tax attributes attributable to debtor.* Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of \$170.

(1) *Reduction of net operating losses.* Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S1 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is reduced by \$10, the portion of the consolidated net operating loss for Year 3 attributable to S1, to \$40. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$20, the portion of that consolidated net operating loss carryover attributable to S1, to \$30, and the consolidated net operating loss carryover from Year 2 is reduced by \$30, the portion of that consolidated net operating loss carryover attributable to S1, to \$40.

(2) *Reduction of basis.* Following the reduction of the net operating loss and the net operating loss carryovers attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S2 by \$80, from \$80 to \$0.

(3) *Tiering down of stock basis reduction.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this

section, S2 is treated as realizing \$80 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S2 under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is reduced by an additional \$40, the portion of the consolidated net operating loss for Year 3 attributable to S2, to \$0. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$20, the portion of that consolidated net operating loss carryover attributable to S2, to \$10. Then, the consolidated net operating loss carryover from Year 2 is reduced by \$10, the portion of that consolidated net operating loss carryover attributable to S2, to \$30. S2's remaining \$10 of excluded COD income does not reduce consolidated tax attributes attributable to P or S1 under paragraph (a)(4) of this section.

(B) *Reduction of remaining consolidated tax attributes.* Finally, pursuant to paragraph (a)(4) of this section, S1's remaining \$30 of excluded COD income reduces the remaining consolidated tax attributes. In particular, the remaining \$10 consolidated net operating loss carryover from Year 1 is reduced by \$10 to \$0, and the remaining \$30 consolidated net operating loss carryover from Year 2 is reduced by \$20 to \$10.

Example 3. (i) *Facts.* P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of S1, S1 owns 100 percent of the stock of S2, and S2 owns 100 percent of the stock of S3. None of P, S1, S2, or S3 had a separate return limitation year prior to Year 1. In Year 1, the P group sustained a \$150 consolidated net operating loss. Under the principles of § 1.1502-21(b)(2)(iv), of that amount, \$50 was attributable to S2, and \$100 was attributable to S3. In Year 2, the P group sustained a \$50 consolidated net operating loss. Under the principles of § 1.1502-21(b)(2)(iv), of that amount, \$40 was attributable to S1 and \$10 was attributable to S2. In Year 3, S1 realized \$170 of excluded COD income from the discharge of non-intercompany indebtedness. In that same year, the P group sustained a \$50 consolidated net operating loss, of which \$10 was attributable to S1, \$20 was attributable to S2, and \$20 was attributable to S3 under the principles of § 1.1502-21(b)(2)(iv). At the beginning of Year 4, S1's only asset was the stock of S2, and S2's only asset was the stock of S3 with a value of \$10. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and this section, S1's stock of S2 had a basis of \$120 and S2's stock of S3 had a basis of \$180. In addition, none of S1, S2, and S3 had any liabilities.

(ii) *Analysis—(A) Reduction of tax attributes attributable to debtor.* Pursuant to paragraph

(a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of \$170.

(1) *Reduction of net operating losses.* Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S1 under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is reduced by \$10, the portion of the consolidated net operating loss attributable to S1, to \$40. Then, the consolidated net operating loss carryover from Year 2 is reduced by \$40, the portion of that consolidated net operating loss carryover attributable to S1, to \$10.

(2) *Reduction of basis.* Following the reduction of the net operating loss and the net operating loss carryovers attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and § 1.1017-1. Accordingly, S1 reduces its basis in the stock of S2 by \$120, from \$120 to \$0.

(B) *Tiering down of stock basis reduction to S2.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing \$120 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S2 under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is further reduced by \$20, the portion of the consolidated net operating loss attributable to S2, to \$20. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$50, the portion of that consolidated net operating loss carryover attributable to S2, to \$100. Then, the consolidated net operating loss carryover from Year 2 is further reduced by \$10, the portion of that consolidated net operating loss carryover attributable to S2, to \$0. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S2, S2 reduces its basis in its assets pursuant to section 1017 and § 1.1017-1. Accordingly, S2 reduces its basis in its S3 stock by \$40 to \$140.

(C) *Tiering down of stock basis reduction to S3.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing \$40 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and the net operating loss carryovers attributable to S3 under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is further reduced by \$20, the portion of the consolidated

net operating loss attributable to S3, to \$0. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$20, the lesser of the portion of that consolidated net operating loss carryover attributable to S3 and the remaining excluded COD income, to \$80.

Example 4. (i) *Facts.* P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of each of S1 and S2. Each of S1 and S2 owns stock of S3 that represents 50 percent of the value of the stock of S3. None of P, S1, S2, or S3 had a separate return limitation year prior to Year 1. In Year 1, the P group sustained a \$160 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, \$10 was attributable to P, \$50 was attributable to S2, and \$100 was attributable to S3. In Year 2, the P group sustained a \$110 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, \$40 was attributable to S1 and \$70 was attributable to S2. In Year 3, S1 realized \$200 of excluded COD income from the discharge of non-intercompany indebtedness, and S2 realized \$270 of excluded COD income from the discharge of non-intercompany indebtedness. In that same year, the P group sustained a \$50 consolidated net operating loss, of which \$10 was attributable to S1, \$20 was attributable to S2, and \$20 was attributable to S3 under the principles of §1.1502-21(b)(2)(iv). At the beginning of Year 4, S3 had one asset with a value of \$10. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and this section, S1's basis in its S3 stock was \$60, S2's basis in its S3 stock was \$120, and S3's asset had a basis of \$200. In addition, none of S1, S2, and S3 had any liabilities.

(ii) *Analysis—(A) Reduction of tax attributes attributable to debtors.* Pursuant to paragraph (b)(1)(i) of this section, the tax attributes attributable to each of S1 and S2 are reduced pursuant to paragraph (a)(2) of this section. Then, pursuant to paragraph (a)(3) of this section, the tax attributes attributable to S3 are reduced so as to reflect a reduction of S1's and S2's basis in the stock of S3. Then, paragraph (a)(4) is applied to reduce additional tax attributes.

(1) *Reduction of net operating losses generally.* Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating losses and the net operating loss carryovers attributable to S1 and S2 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B).

(2) *Reduction of net operating losses attributable to S1.* The consolidated net operating loss for Year 3 is reduced by \$10, the portion of the consolidated net operating loss attributable to S1, to \$40. Then, the consolidated net operating loss carryover from Year 2 is

reduced by \$40, the portion of that consolidated net operating loss carryover attributable to S1, to \$70.

(3) *Reduction of net operating losses attributable to S2.* The consolidated net operating loss for Year 3 is also reduced by \$20, the portion of the consolidated net operating loss attributable to S2, to \$20. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$50, the portion of that consolidated net operating loss carryover attributable to S2, to \$110. Then, the consolidated net operating loss carryover from Year 2 is reduced by \$70, the portion of that consolidated net operating loss carryover attributable to S2, to \$0.

(4) *Reduction of basis.* Following the reduction of the net operating losses and the net operating loss carryovers attributable to S1 and S2, S1 and S2 must reduce their basis in their assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S3 by \$60, from \$60 to \$0, and S2 reduces its basis in the stock of S3 by \$120, from \$120 to \$0.

(B) *Tiering down of basis reduction.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing \$180 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and the net operating loss carryovers attributable to S3 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is further reduced by \$20, the portion of the consolidated net operating loss attributable to S3, to \$0. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$100, the portion of that consolidated net operating loss carryover attributable to S3, to \$10. Following the reduction of the net operating loss and the net operating loss carryover attributable to S3, S3 reduces its basis in its asset pursuant to section 1017 and §1.1017-1. Accordingly, S3 reduces its basis in its asset by \$60, from \$200 to \$140.

(C) *Reduction of remaining consolidated tax attributes.* Finally, pursuant to paragraph (a)(4) of this section, the remaining \$90 of S1's excluded COD income and the remaining \$10 of S2's excluded COD income reduce the remaining consolidated tax attributes. In particular, the remaining \$10 consolidated net operating loss carryover from Year 1 is reduced by \$10 to \$0. Because that amount is less than the aggregate amount of remaining excluded COD income, such income is applied on a pro rata basis to reduce the remaining consolidated tax attributes. Accordingly, \$9 of S1's remaining excluded COD income and \$1 of S2's remaining excluded COD income is applied to reduce the remaining consolidated net operating loss carryover from Year 1. Consequently, of S1's excluded COD income

of \$200, only \$119 is applied to reduce tax attributes, and, of S2's excluded COD income of \$270, only \$261 is applied to reduce tax attributes.

Example 5. (i) *Facts.* P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of S1 and S2, and S1 owns 100 percent of the stock of S3. None of P, S1, S2, or S3 has a separate return limitation year prior to Year 1. In Year 1, the P group sustained a \$90 consolidated net operating loss. Under the principles of § 1.1502-21(b)(2)(iv), of that amount, \$10 was attributable to P, \$15 was attributable to S1, \$20 was attributable to S2, and \$45 was attributable to S3. On January 1 of Year 2, P realized \$140 of excluded COD income from the discharge of non-intercompany indebtedness. On December 31 of Year 2, S1 issued stock representing 50 percent of the vote and value of its outstanding stock to a person that was not a member of the group. As a result of the issuance of stock, S1 and S3 ceased to be members of the P group. For the consolidated return year of Year 2, the P group sustained a \$60 consolidated net operating loss, of which \$5 was attributable to S1, \$40 was attributable to S2, and \$15 was attributable to S3 under the principles of § 1.1502-21(b)(2)(iv). As of the beginning of Year 3, P's only assets were the stock of S1 and S2, S1's sole asset was the stock of S3, S2 had Asset A with a value of \$10, and S3 had Asset B with a value of \$10. After the computation of tax imposed for Year 2 and before the application of sections 108 and 1017 and this section, P had a \$80 basis in the S1 stock and a \$50 basis in the S2 stock, S1 had a \$80 basis in the S3 stock, and Asset A and B each had a basis of \$10. In addition, none of P, S1, S2, and S3 had any liabilities.

(ii) *Analysis.* Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to P must first be reduced to take into account its excluded COD income in the amount of \$140.

(A) *Reduction of net operating losses.* Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryover attributable to P under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss carryover from Year 1 is reduced by \$10, the portion of that consolidated net operating loss carryover attributable to P, to \$80.

(B) *Reduction of basis.* Following the reduction of the net operating loss and the net operating loss carryover attributable to P, P reduces its basis in its assets pursuant to section 1017 and § 1.1017-1. Accordingly, P reduces its basis in the stock of S1 by \$80, from \$80 to \$0, and its basis in the stock of S2 by \$50, from \$50 to \$0.

(C) *Tiering down of stock basis reduction to S1.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S1 is treated as realizing \$80 of excluded COD income, despite the fact that it ceases to be a member of the group at the end of the day on December 31 of Year 2. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S1 under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 2 is reduced by \$5, the portion of the consolidated net operating loss for Year 2 attributable to S1, to \$55. Then, the consolidated net operating loss carryover from Year 1 is reduced by an additional \$15, the portion of that consolidated net operating loss carryover attributable to S1, to \$65. Following the reduction of the net operating loss and the net operating loss carryover attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and § 1.1017-1. Accordingly, S1 reduces its basis in the stock of S3 by \$60, from \$80 to \$20.

(D) *Tiering down of stock basis reduction to S2.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing \$50 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S2 under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 2 is reduced by an additional \$40, the portion of the consolidated net operating loss for Year 2 attributable to S2, to \$15. Then, the consolidated net operating loss carryover from Year 1 is reduced by an additional \$10, a portion of the consolidated net operating loss carryover attributable to S2, to \$55.

(E) *Tiering down of stock basis reduction to S3.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing \$60 of excluded COD income (by reason of S1's reduction in its basis of its S3 stock). Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S3 under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 2 is reduced by an additional \$15, the portion of the consolidated net operating loss for Year 2 attributable to S3, to \$0. Then, the consolidated net operating loss carryover from Year 1 is reduced by an additional \$45, the portion of that consolidated net operating loss carryover attributable to S3, to \$10.

Example 6. (i) *Facts.* P1 is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P1 owns 100 percent of the stock of S1 and S2. S1 owns 100 percent of the stock of S3. None of P1, S1, S2, or S3 has a separate return limitation year prior to Year 1. In Year 1, the P1 group sustained a \$120 consolidated net operating loss. Under the principles of § 1.1502-21(b)(2)(iv), of that amount, \$40 was attributable to P1, \$35 was attributable to S1, \$30 was attributable to S2, and \$15 was attributable to S3. On January 1 of Year 2, S3 realized \$65 of excluded COD income from the discharge of non-intercompany indebtedness. On June 30 of Year 2, S3 issued stock representing 80 percent of the vote and value of its outstanding stock to P2, the common parent of another group. As a result of the issuance of stock, S3 ceased to be a member of the P1 group and became a member of the P2 group. For the consolidated return year of Year 2, the P1 group sustained a \$50 consolidated net operating loss, of which \$5 was attributable to S1, \$40 was attributable to S2, and \$5 was attributable to S3 under the principles of § 1.1502-21(b)(2)(iv). As of the beginning of its taxable year beginning on July 1 of Year 2, S3's sole asset was Asset A with a \$10 value. After the computation of tax imposed for Year 2 on the P1 group and before the application of sections 108 and 1017 and this section and the computation of tax imposed for Year 2 on the P2 group, Asset A had a basis of \$0. In addition, S3 had no liabilities. On January 1 of Year 3, P1 sold all of its stock of S1.

(i) *Analysis—(A) Reduction of tax attributes attributable to debtor.* Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S3 must first be reduced to take into account its excluded COD income in the amount of \$65. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryover attributable to S3 under the principles of § 1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 2 is reduced by \$5, the portion of the consolidated net operating loss for Year 2 attributable to S3, to \$45. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$15, the portion of that consolidated net operating loss carryover attributable to S3, to \$105.

(B) *Reduction of remaining consolidated tax attributes.* Pursuant to paragraphs (a)(4) and (b)(8) of this section, S3's remaining \$45 of excluded COD income reduces the remaining consolidated tax attributes in the P1 group. In particular, the remaining \$45 consolidated net operating loss for Year 2 is reduced by an additional \$45 to \$0.

(C) *Basis Adjustments.* For purposes of computing P1's gain or loss on the sale of the S1 stock in Year 3, P1's basis in its S1 stock will reflect a net positive adjustment of \$40,

which is the excess of the amount of S3's excluded COD income that is applied to reduce attributes (\$65) over the reduction of S1's and S3's attributes in respect of such excluded COD income (\$25).

Example 7. (i) *Facts.* P is the common parent of a consolidated group that includes subsidiaries S1 and S2. P owns 100 percent of the stock of S1, and S1 owns 100 percent of the stock of S2. None of P, S1, or S2 has a separate return limitation year prior to Year 1. In Year 1, the P group sustained a \$50 consolidated net operating loss. Under the principles of § 1.1502-21(b)(2)(iv), of that amount, \$10 was attributable to P, \$20 was attributable to S1, and \$20 was attributable to S2. On January 1 of Year 2, S1 realized \$55 of excluded COD income from the discharge of non-intercompany indebtedness. On June 30 of Year 2, P transferred all of its assets to S1 in a transaction to which section 381(a) applied. As a result of that transaction, pursuant to § 1.1502-75(d)(2)(ii), S1 succeeded P as the common parent of the group. Pursuant to § 1.1502-75(d)(2)(iii), S1's taxable year closed on the date of the acquisition. However, P's taxable year did not close. On the consolidated return for Year 2, the group sustained a \$50 consolidated net operating loss. Under the principles of § 1.1502-21(b)(2)(iv), of that amount, \$10 was attributable to S1 for its taxable year that ended on June 30, \$15 was attributable to S1 as the successor of P, and \$25 was attributable to S2.

(ii) *Analysis.* Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of \$55. For this purpose, S1's attributes that remain after the determination of tax for the group for Year 2 are subject to reduction. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryover attributable to S1 under the principles of § 1.1502-21(b)(2)(iv) are reduced. Accordingly, the consolidated net operating loss for Year 2 is reduced by \$25, the portion of the consolidated net operating loss for Year 2 attributable to S1, to \$25. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$30, the portion of that consolidated net operating loss carryover attributable to S1 (which includes the portion attributable to P), to \$20.

(d) *Effective dates.* This section applies to discharges of indebtedness that occur after March 21, 2005. Groups, however, may apply this section in whole, but not in part, to discharges of indebtedness that occur on or before March 21, 2005, and after August 29, 2003. For discharges of indebtedness occurring on or before March 21, 2005, and

after August 29, 2003, with respect to which a group chooses not to apply this section, see § 1.1502-28T as contained in 26 CFR part 1 revised as of April 1, 2004. Furthermore, groups may apply paragraph (b)(4) of this section to discharges of indebtedness that occur on or before August 29, 2003, in cases in which section 1017(b)(3)(D) was applied. Paragraph (b)(5)(i) of this section and the last sentence of paragraph (b)(5)(ii) of this section applies to transactions occurring in consolidated return years beginning on or after December 24, 2008.

[T.D. 9192, 70 FR 14404, Mar. 22, 2005, as amended by T.D. 9442, 73 FR 79334, Dec. 29, 2008]

BASIS, STOCK OWNERSHIP, AND EARNINGS AND PROFITS RULES

§ 1.1502-30 Stock basis after certain triangular reorganizations.

(a) *Scope.* This section provides rules for determining the basis of the stock of an acquiring corporation as a result of a triangular reorganization. The definitions and nomenclature contained in § 1.358-6 apply to this section.

(b) *General rules*—(1) *Forward triangular merger, triangular C reorganization, or triangular B reorganization.* *P* adjusts its basis in the stock of *S* as a result of a forward triangular merger, triangular C reorganization, or triangular B reorganization under § 1.358-6(c) and (d), except that § 1.358-6(c)(1)(ii) and (d)(2) do not apply. Instead, *P* adjusts such basis by taking into account the full amount of—

(i) *T* liabilities assumed by *S* or the amount of liabilities to which the *T* assets acquired by *S* are subject, and

(ii) The fair market value of any consideration not provided by *P* pursuant to the plan of reorganization.

(2) *Reverse triangular merger.* If *P* adjusts its basis in the *T* stock acquired as a result of a reverse triangular merger under § 1.358-6(c)(2)(i) and (d), § 1.358-6(c)(1)(ii) and (d)(2) do not apply. Instead, *P* adjusts such basis by taking into account the full amount of—

(i) *T* liabilities deemed assumed by *S* or the amount of liabilities to which the *T* assets deemed acquired by *S* are subject, and

(ii) The fair market value of any consideration not provided by *P* pursuant to the plan of reorganization.

(3) *Excess loss accounts.* Negative adjustments under this section may exceed *P*'s basis in its *S* or *T* stock. The resulting negative amount is *P*'s excess loss account in its *S* or *T* stock. See § 1.1502-19 for rules treating excess loss accounts as negative basis, and treating references to stock basis as including references to excess loss accounts.

(4) *Application of other rules of law.* If a transaction otherwise subject to this section is also a group structure change subject to § 1.1502-31, the provisions of § 1.1502-31 and not this section apply to determine stock basis. See § 1.1502-80(a) regarding the general applicability of other rules of law and a limitation on duplicative adjustments. See § 1.1502-80(d) for the non-application of section 357(c) to *P*.

(5) *Examples.* The rules of this paragraph (b) are illustrated by the following examples. For purposes of these examples, *P*, *S*, and *T* are domestic corporations, *P* and *S* file consolidated returns, *P* owns all of the only class of *S* stock, the *P* stock exchanged in the transaction satisfies the requirements of the applicable triangular reorganization provisions, the facts set forth the only corporate activity, and tax liabilities are disregarded.

Example 1. Liabilities. (a) *Facts.* *T* has assets with an aggregate basis of \$60 and fair market value of \$100. *T*'s assets are subject to \$70 of liabilities. Pursuant to a plan, *P* forms *S* with \$5 of cash (which *S* retains), and *T* merges into *S*. In the merger, the *T* shareholders receive *P* stock worth \$30 in exchange for their *T* stock. The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(D) apply.

(b) *Basis adjustment.* Under § 1.358-6, *P* adjusts its \$5 basis in the *S* stock as if *P* had acquired the *T* assets with a carryover basis under section 362 and transferred these assets to *S* in a transaction in which *P* determines its basis in the *S* stock under section 358. Under the rules of this section, the limitation described in § 1.358-6(c)(1)(ii) does not apply. Thus, *P* adjusts its basis in the *S* stock by -\$10 (the aggregate adjusted basis of *T*'s assets decreased by the amount of liabilities to which the *T* assets are subject). Consequently, as a result of the reorganization, *P* has an excess loss account of \$5 in its *S* stock.

Example 2. Consideration not provided by P. (a) *Facts.* *T* has assets with an aggregate